

Tax Treatment by Other Jurisdictions of Electronically Delivered Products

For a view of the taxation of electronically delivered products by other jurisdictions, the tax structures of the European Union (EU), Canada, and the United States (including the Streamline Sales and Use Tax Agreement (SSUTA)) were reviewed. This review sought the answers to two key questions:

1. What are the jurisdictions' equivalent of electronically delivered products; and
2. What are the jurisdictions' tax treatments of such equivalent electronically delivered products?

European Union (EU)

The EU applies its value-added tax (VAT), a consumption tax, to electronically delivered products. For consumption purposes, all sales of supplies (goods or services) provided via the Internet are characterized as "supplies of service."

Examples of "electronically supplied services" include:

- Website supply, web-hosting, distance maintenance of programs and equipment.
- Software and software updates.
- Database Access.
- Music, films and games, including games of chance and gambling games, and of political, cultural, artistic, sporting, scientific and entertainment broadcasts and events.
- On-line access to education.
- Online access to banking and brokerage service, and advertising services.

The EU's conclusion that electronically delivered products are services does not impact the taxability of electronically delivered products because both goods and services are generally subject to the VAT.

Canada

Canada does not consider electronically delivered products to be tangible personal property. Canada characterizes a "supply made by electronic means" as either a supply of intangible personal property or a supply of service. The Canada Customs and Revenue Agency (CCRA) uses multiple factor tests to make this distinction.

A sale of intangible personal property occurs when there is the sale of:

- A right in a product or a right to use a product for personal or commercial purposes, such as:
 - Intellectual property or a right to use intellectual property (e.g., a copyright); or

- Rights of a temporary nature (e.g., a right to view, access or use a product while on-line);
- A product that has already been created or developed;
- A product created or developed for a specific customer and the supplier retains ownership of the product; and
- A right to copy a digitized product.

The sale of the supply of a service occurs when:

- The supply does not include the provision of rights (e.g., technical know-how), or if there is a provision of rights, the rights are incidental to the supply;
- The supply involves specific work that is performed by a person for a specific customer; and
- There is human involvement in making the supply.

Canada imposes the GST/HST¹ consumption tax on both types of electronically delivered products, intangible personal property and services, as well as on tangible personal property, intangible personal property and services not delivered electronically. Both intangible personal property/service and goods are taxed. The distinction merely determines whether the seller collects and remits GST/HST (goods) or the buyer self-assesses GST/HST (service/IPP), not whether the electronically delivered product is subject to tax in Canada.

United States (and SSUTA)

The fifty states have taken different approaches to defining and taxing digital goods. This was shown in a survey of the fifty states with respect to cell phone downloads of ring tones, games, music, pictures, and other information.² Twenty-one states impose sales and use tax on the charges for these downloads. Five states do not impose sales and use tax. Four states have sales and use tax, but do not impose sales and use tax on these cell phone related transactions. The remaining twenty states do not impose sales and use tax on the charges for these downloads.

The following four states exemplify the spectrum of approaches. These two states are examples the intangible personal property side:

- New York defines prewritten computer software as tangible personal property for sales tax purposes, but “charges for music, audio recordings, or artwork delivered electronically for download on customers’ computers or other devices are not sales of tangible personal property and are thus not subject to sales tax.”³

¹ The goods and services tax (GST) applies to the supply of most goods and services in Canada. The GST rate is 6%, and the HST rate is 14%. Three provinces (Nova Scotia, New Brunswick, and Newfoundland and Labrador) harmonized their provincial sales tax with the GST to create the harmonized sales tax (HST). The HST applies to the same base of taxable goods and services as the GST.

² “Sales/Use Tax Treatment of Cell Phone Related Transactions (Part 2),” Healey, John C. and Michael S. Schadowald, 2007 Multistate Corporate Tax Guide Volume II, Sales/Use Tax (CCH 2006) II-486.

³ Advisory Opinion S060313A, TSB-A-07(16)S, 2007 WL 2026396 (N.Y. Dept. Tax. Fin.).

- Tennessee holds that “digital transmissions of anything other than software are not tangible personal property and are not subject to tax since they are not taxable services. This position essentially exempts solely based on the mode of transmission, as transmissions of electronic files contained on discs, tapes, or other tangible media are taxable.”⁴

Examples on the tangible personal property side of the spectrum include:

- Alabama held that digital photographs constitute tangible personal property and that gross proceeds from the retail sale of those electronically transmitted photographs thus are subject to the Alabama sales tax.”⁵
- Utah holds music to be tangible personal property in the form of prewritten computer software or computer generated output.⁶ However, the Utah Tax Commission has ruled that a charge to simply access a database is not taxable if items are not downloaded onto the customer’s computer.

SSUTA

In 2001, Streamline Sales Tax Project began an initial survey of participating states on the tax treatment of digital goods. At the time, nine states taxed digitized goods. Six of these states appeared to tax them on the theory that digitized goods are tangible personal property. Fourteen states did not tax digitized goods. Nine of these states appeared to exempt them from tax on the theory that digitized goods are not tangible personal property.

On September 20, 2007 and effective January 1, 2008, SSUTA was amended to define three specified digital goods (digital audio-visual, digital audio, and digital books) as not being tangible personal property. All other electronically delivered products will not be tangible personal property under the SSUTA definition effective of January 1, 2010.

Therefore, under SSUTA, member states cannot and will not be able to impose RST on electronically delivered products under the basis that electronically delivered products are tangible personal property. Member states may impose RST on electronically delivered products separate from its imposition tax on electronically transferred products, but the state must specifically impose and enumerate whether the tax is only on end-users or rebroadcasters, permanent right users or terminable right users, and subscribers or non-subscribers.

⁴ Tennessee Department of Revenue Sales and Use Tax Guide, February 2007 at page 10.

⁵ *Robert Smith d/b/a FlipFlopFoto v. State Department of Revenue*, Admin. L. Div. Dkt. No. S05-1240.

⁶ *See South Cent. Utah Telephone Ass’n, Inc., v. Auditing Div. of Utah State Tax Comm.*, 951 P.2d 218 (1997). *See also* Utah Administrative Rule R865-19S-92.